



DOR Directive 95-9

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Massachusetts
Department of
RevenueUniversity of Massachu
Depository Copy**Tax Treatment of Scholarships and Grants for Residents and Non-Residents of Massachusetts****Facts 1:**

Taxpayer Jones is an undergraduate student at a university located in Massachusetts. Taxpayer Jones receives a scholarship covering his tuition, fees, and living expenses incurred as a student at the university. Taxpayer Jones is a resident of Massachusetts.

Issue 1:

To what extent are scholarships and grants includable in the gross income of a Massachusetts resident for Massachusetts personal income tax purposes?

Directive 1:

Scholarship and grant amounts are included in Massachusetts gross income to the extent that they are included in federal gross income under Internal Revenue Code § 117. Amounts that are not so included are not taxable in Massachusetts. G.L. c. 62, § 2. "Qualified scholarship" amounts are excluded from both federal and Massachusetts gross income and are not subject to Massachusetts personal income tax.

Facts 2:

Taxpayer Smith is a graduate student at a university located in Massachusetts. Taxpayer Smith receives a stipend or grant covering her tuition, fees and living expenses while she is a student at the university. Taxpayer Smith is required to teach in return for the grant. Taxpayer Smith is not a resident of Massachusetts.

Issue 2:

To what extent are scholarships and grants includable in the taxable income of a Massachusetts non-resident for Massachusetts personal income tax purposes?

Directive 2:

Scholarship and grant amounts that are derived from or effectively connected with teaching, research or other services carried on by a non-resident in Massachusetts are includable in a non-resident's federal and Massachusetts gross income and therefore taxable under G.L. c. 62, § 5A. "Qualified scholarship" amounts are excluded from both federal and Massachusetts gross income whether or not the recipient is a Massachusetts resident.

Discussion of Law**A. Federal Law**

Under Internal Revenue Code ("I.R.C.") Section 117, federal gross income does not include any amount received as a "qualified scholarship" by an individual who is a candidate for a degree at an educational institution as described in I.R.C. § 170(b)(1)(A)(ii). A qualified scholarship is defined as "any amount received by an individual as a scholarship or fellowship grant to the ex-

tent the individual establishes that, in accordance with the conditions of the grant, such amount was used for qualified tuition and related expenses." I.R.C. § 117(b)(2). Qualified tuition and related expenses are limited to tuition, fees, books, supplies and equipment required for study. *Id.* Amounts used for expenses such as room and board or other living expenses are not considered to be "qualified tuition and related expenses" and are not excluded from federal gross income. Amounts received by a student as payment for teaching, research, or other services in the nature of part-time employment required as a condition to receiving a scholarship or grant are not excluded from gross income. Treas. Reg. § 1.117-2(a)(1); I.R.C. § 117(c).

B. Massachusetts Law

Massachusetts gross income includes all items included in federal gross income as defined in the Internal Revenue Code as amended and in effect as of January 1, 1988, unless there exists a specific modification in the Massachusetts General Laws which includes a federally excluded item or excludes a federally included item from Massachusetts gross income. G.L. c. 62, § 2. Similarly, items that are excluded from federal gross income are excluded from Massachusetts gross income.

Since qualified scholarship amounts are excluded from federal gross income under I.R.C. Section 117, and no Massachusetts modification applies, such amounts are also excluded from Massachusetts gross income. The tax treatment of such amounts is the same whether the taxpayer is a resident or non-resident of Massachusetts. G.L. c. 62, § 2.

Scholarship and grant amounts that are included in federal gross income under I.R.C. § 117 (such as amounts for living expenses) similarly are also includable in Massachusetts gross income and are taxable under G.L. c. 62, § 2(a) when paid to a resident of Massachusetts.

For non-residents, however, the tax treatment of scholarship and grant amounts is limited. Non-residents are taxed *only* on items of gross income that are derived from or effectively connected with any trade or business, including 1) any employment carried on by the taxpayer in the commonwealth; 2) the participation in any lottery or wagering transaction within the commonwealth; or 3) the ownership of any interest in real or tangible personal property located in the commonwealth. G.L. c. 62, § 5A(a). While G.L. c. 62, § 5A mentions items of gross income from "sources within the commonwealth," the statute defines "sources" in terms of activities that occur in Massachusetts. Therefore, scholarship and grant amounts that are derived from or effectively connected with "teaching, research or other services" *carried on* by a non-resident *in Massachusetts* are includable in Massachusetts gross income and subject to Massachusetts personal income tax, re-

ardless of whether such amounts are paid by a granting organization located within or without Massachusetts. The location of the payor or grantor is irrelevant. It is where the activities are carried on by the grantee that determines taxability of such amounts. Scholarship and grant amounts that are received by a non-resident and *specifically designated* for use for living expenses, however, are not subject to Massachusetts personal income tax, since they are not connected to an activity specified in G.L. c. 62, § 5A(a).



Mitchell Adams
Commissioner of Revenue
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